

**Illinois Department of Revenue
Regulations**

Title 86 Part 100 Section 100.2197 Foreign Tax Credit (IITA Section 601(b)(3))

TITLE 86: REVENUE

**PART 100
INCOME TAX**

Section 100.2197 Foreign Tax Credit (IITA Section 601(b)(3))

- a) IITA Section 601(b)(3) provides that *the aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by Section 201(a) and (b) of the Illinois Income Tax Act shall be credited against the tax imposed by Section 201(a) and (b) otherwise due under the Illinois Income Tax Act for such taxable year.*
- b) Definitions applicable to this Section.
 - 1) Tax qualifying for the credit. A tax qualifies for the credit only if it is *imposed upon or measured by income* and is *paid by an Illinois resident* to another state *on income which is also subject to Illinois income tax.*
 - A) A tax "imposed upon or measured by income" shall mean an income tax or tax on profits imposed by a state and deductible under IRC section 164(a)(3). Such term shall not include penalties or interest imposed with respect to the tax.
 - B) A tax is "paid by an Illinois resident" to another state "on income which is also subject to Illinois income tax" only to the extent the income included in the tax base of the other state is also included in base income computed under IITA Section 203 during a period in which the taxpayer is an Illinois resident. Thus, for example, income tax paid to another state on retirement income excluded from base income under IITA Section 203(a)(2)(F) does not qualify for the credit, nor would income derived from a partnership or Subchapter S corporation whose tax year ends during a period in which the taxpayer is not an Illinois resident. See IRC section 706(a) and IRC section 1366(a)(1). If tax is paid to another state on income that is not included in base income or on income attributable to a period when the taxpayer was not a resident of Illinois, as well as on income that is included in base income and attributable to a period in which the taxpayer was a resident of Illinois, the amount of tax qualifying for the credit shall be determined by multiplying the tax paid by a fraction equal to the income taxed by the other state that is included in base income and attributable to a period in which the taxpayer was a resident of Illinois divided by the total tax base on which the other state's tax was computed.

- 2) For purposes of IITA Section 601(b)(3), "state" *means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States, or any political subdivision of any of the foregoing.* (IITA Section 1501(a)(22)) This definition is effective for tax years ending on or after December 31, 1989. The term "state" does not include foreign countries or any political subdivision of a foreign country.
- 3) "Resident" is defined at IITA Section 1501(a)(20) and in Section 100.3020 of this Part.
- 4) *Base income subject to tax both by another state and by this State* or "double-taxed income" means items of income minus items deducted or excluded in computing the tax for which credit is claimed, to the extent such items of income, deduction or exclusion are taken into account in the computation of base income under IITA Section 203 for the person claiming the credit. However, under IITA Section 601(b)(3), as in effect prior to January 1, 2006 (the effective date of Public Act 94-247), *no compensation received by a resident which qualifies as compensation paid in this State as determined under IITA Section 304(a)(2)(B) shall be considered income subject to tax by another state or states.*
 - A) Under IITA Section 203(a), base income of an individual is computed without allowing the standard deduction allowed in computing federal taxable income, and without allowing the exemptions provided in IITA Section 204. Double-taxed income is therefore computed without reduction for any standard deductions or exemptions allowed by the state.
 - B) An item of income is not included in double-taxed income to the extent it is excluded or deducted in computing the tax for which the credit is claimed. For example, State X allows a deduction or exclusion equal to 60% of long-term capital gains and for 100% of winnings from the State X lottery. Only 40% of long-term capital gains is subject to tax in that state. Similarly, an individual subject to the Washington, D.C. unincorporated business tax is allowed to deduct from taxable income a reasonable allowance for compensation for personal services rendered. This deduction is in fact an exclusion for the "personal income" of the individual, which Congress has forbidden Washington, D.C. to tax except in the case of residents. Accordingly, double-taxed income is net of this deduction.
 - C) An item of income that is excluded, subtracted or deducted in the computation of base income under IITA Section 203 cannot be included in double-taxed income. For example, IITA Section 203(a)(2)(L) allows a subtraction for federally-taxed Social Security and Railroad Retirement benefits, while dividends received from a Subchapter S corporation are excluded from federal gross income and therefore from base income. Accordingly, even if another state taxes such benefits or dividends, these amounts are not included in double-taxed income.
 - D) An item of expense is deducted or subtracted in computing double-taxed income only to the extent that item is deducted or subtracted in computing the tax base in the other state and in computing base income under IITA

Section 203. For example, State Y allows deductions for federal itemized deductions and for individual federal income taxes paid. No deduction for federal income taxes is allowed in computing base income under IITA Section 203, and so that deduction is not taken into account in computing base income subject to tax in State Y. Also, IITA Section 203(a) generally does not allow a deduction for federal itemized deductions, and so federal itemized deductions are generally not taken into account in computing base income subject to tax in State Y. However, IITA Section 203(a)(2)(V) allows self-employed individuals a subtraction modification for health insurance premiums, which can be taken as an itemized deduction in computing federal taxable income. Accordingly, in the case of a self-employed individual eligible for the Illinois subtraction, any itemized deduction for health insurance premiums taken into account in computing the State Y tax base is also taken into account in computing double-taxed income.

- E) For taxable years beginning prior to January 1, 2006, compensation paid in Illinois under IITA Section 304(a)(2)(B), as further explained in Section 100.3120 of this Part, is not included in double-taxed income, even if another state taxes such compensation. For example, an Illinois resident whose base of operations is in Illinois, but whose employment requires him or her to work in Illinois and for a substantial period of time in State Z, must treat all compensation from such employment as paid in Illinois under IITA Section 304(a)(2)(B)(iii). None of that compensation may be included in double-taxed income, even if State Z actually taxes the compensation earned for periods during which the resident was working in State Z. Public Act 94-247 (effective January 1, 2006) repealed the provision in IITA Section 601(b)(3) that stated compensation paid in Illinois may not be included in double-taxed income, and so compensation paid in Illinois may be included in double-taxed income in taxable years beginning on or after January 1, 2006.
- F) Some states impose an alternative minimum tax similar to the tax imposed by IRC section 55, under which a taxpayer computes a regular taxable income and also computes an alternative minimum taxable income by reducing some exclusions or deductions, and eliminating other exclusions and deductions entirely. The taxpayer applies different rate structures to regular taxable income and to alternative minimum taxable income, and is liable for the higher of the two taxes so computed. An item of income included in a state's alternative minimum taxable income but not in the regular taxable income of that state is not included in base income subject to tax in that state unless the taxpayer is actually liable for alternative minimum tax in that state. For example, a state allows a 60% capital gains exclusion for regular tax purposes, but includes 100% of the capital gains in its alternative minimum taxable income. If a taxpayer incurs alternative minimum tax liability in that state, 100% of the capital gains is included in double-taxed income. If only regular tax liability is incurred, only 40% of capital gains is included in double-taxed income.
- G) Some states compute the tax liability of a nonresident by first computing the tax on all income of the nonresident from whatever source derived, and then multiplying the resulting amount by a percentage equal to in-

state sources of income divided by total sources of income or by allowing a credit based on the percentage of total income from sources outside the state. Other states determine the tax base of a nonresident by computing the tax base as if the person were a resident and multiplying the result by the percentage equal to in-state sources of income divided by total sources of income. The use of either of these methods of computing tax does not mean that income from all sources is included in double-taxed income. See *Comptroller of the Treasury v. Hickey*, 114 Md. App. 388, 689 A.2d 1316 (1997); *Chin v. Director, Division of Taxation*, 14 N.J. Tax 304 (T.C. N.J. 1994). When a state uses either of these methods of computation, double-taxed income shall be the base income of the taxpayer from all sources subject to tax in that state, as computed in accordance with the rest of this subsection (b)(4), multiplied by the percentage of income from sources in that state, as computed under that state's law; provided, however, that no compensation paid in Illinois under IITA Section 304(a)(2)(B) shall be treated as income from sources in that state in computing such percentage in any taxable year beginning prior to January 1, 2006.

EXAMPLE 1: Individual, an Illinois resident, has federal adjusted gross income of \$80,000 in Year 1, comprised of \$75,000 in wages, \$1,000 in taxable interest and \$4,000 in net rental income. Taxable interest includes \$200 in interest on federal government obligations and excludes \$500 in municipal bond interest. The rental income is from property in State X. Individual is subject to \$6,000 in federal income tax in Year 1.

Individual's Illinois base income is \$80,300: his \$80,000 in adjusted gross income, plus \$500 in municipal bond interest, minus \$200 in federal government obligation interest.

State X computes Individual's income subject to its tax by starting with the \$4,000 in net rental income included in his federal adjusted gross income, and requiring him to add back \$3,000 in depreciation allowed on his rental property under IRC Section 168 in excess of straight-line depreciation, and subtracting the portion of his federal income tax liability allocable to his State X income. State X also allows Individual an exemption of \$1,000.

Double-taxed income in this case is \$7,000: the \$4,000 in net rental income plus the \$3,000 addition modification for excess depreciation. The \$3,000 addition modification for excess depreciation is a deduction allowed by Illinois but not by State X, and only the amount of depreciation deductible in both states is taken into account. The subtraction for federal income tax and the exemption are not taken into account in computing base income under IITA Section 203(a), and therefore are not taken into account in computing double-taxed income.

EXAMPLE 2. Assume the same facts as in Example 1, except that State X requires Individual to compute income tax as if he were a resident of State X, and then multiply the result by a fraction equal to his federal adjusted gross income from State X sources divided by total federal adjusted gross income. Under this method, Individual has State X taxable income of \$76,300 (\$80,000 in federal adjusted gross income, plus \$500 in municipal bond interest and \$3,000 in excess depreciation, minus \$200 in federal government obligation interest, \$6,000 in federal income taxes, and the \$1,000 exemption). The fraction actually

taxed by State X is 5% (the \$4,000 in rental income divided by \$80,000 in federal adjusted gross income).

Under subsection (b)(4)(G), double-taxed income is \$4,165, computed as follows. First, State X taxable income is computed using only those items of income and deduction taken into account by both State X and Illinois. Accordingly, the \$6,000 in federal income taxes and the \$1,000 exemption are not taken into account. The State X taxable income so computed is \$83,300 (\$80,000 federal adjusted gross income plus \$3,000 in excess depreciation and \$500 in municipal bond interest minus \$200 in federal government obligation interest). Multiplying that amount by the 5% fraction used by State X yields double-taxed income of \$4,165.

EXAMPLE 3: Assume the same facts as in Example 2, except that State X deems \$10,000 of Individual's wages to be earned in State X. Under IITA Section 304(a)(2)(B)(iii), all of Individual's wages are considered "compensation paid in this State", even though Individual performs services in State X, because Individual's base of operations is in Illinois. Accordingly, Individual's State X taxable income is \$76,300, just as in Example 2, but his fraction allocated to State X is 17.5% (\$10,000 in wages plus \$4,000 in net rental income, the total divided by \$80,000 in federal adjusted gross income).

For taxable years beginning prior to January 1, 2006, Individual's double-taxed income is \$4,165, the same as in Example 2. Because compensation deemed "paid in this State" cannot be treated as double-taxed income, the State X fraction must be computed under subsection (b)(4)(G) without treating the \$10,000 in wages as allocable to State X. Accordingly, double-taxed income is the \$83,300 total of all items taxed by both states minus deductions allowed by both states, times 5% (the \$4,000 in net rental income divided by the \$80,000 in federal adjusted gross income).

For taxable years beginning on or after January 1, 2006, Individual's double-taxed income is \$14,578, which is the \$83,300 total of all items taxed by both states minus deductions allowed by both states, times 175% (the \$10,000 in wages taxed by both states plus the \$4,000 in net rental income, divided by the \$80,000 in federal adjusted gross income).

- c) Amount of the credit. Subject to limitations described in subsection (d) of this Section, the amount of the credit for a taxable year is the *aggregate amount of tax paid by a resident for the taxable year*. (IITA Section 601(b)(3)) Because the credit is allowed for taxes paid for the taxable year, rather than for taxes paid in or during the taxable year:
- 1) The amount of tax withheld for another state, estimated payments made to that state and overpayments from prior years applied against the current liability to that state are not relevant to the computation of the credit.
 - 2) Any credit (including a credit for taxes paid to Illinois or another state, but not including a credit that is allowed for an actual payment of tax, such as a credit for income taxes withheld, for estimated taxes paid or for an overpayment of income tax in another taxable year) that is taken into account in determining the amount of tax actually paid or payable to another state shall reduce the amount of credit to which the taxpayer is entitled under this Section. In a case in which the

taxpayer claims a transferable credit on the other state's return, the credit shall be treated as an actual payment of tax up to the amount the taxpayer paid for the credit, and only the amount of credit in excess of the amount paid shall reduce the amount of credit to which the taxpayer is entitled under this Section.

- 3) Any increase or decrease in the amount of tax paid to another state for a taxable year, as the result of an audit, claim for refund, or other change, shall increase or decrease the amount of credit for that taxable year, not for the taxable year in which the increase or decrease is paid or credited.
- d) Limitations on the amount of credit allowed. *The aggregate credit allowed under IITA Section 601(b)(3) shall not exceed that amount which bears the same ratio to the tax imposed by IITA Section 201(a) and (b) otherwise due as the amount the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year.* (IITA Section 601(b)(3)) The credit allowed under this Section is therefore the smaller of either the total amount of taxes paid to other states for the year or the product of Illinois income tax otherwise due (before taking into account any Article 2 credit or the foreign tax credit allowed under IITA Section 601(b)(3)) multiplied by a fraction equal to the aggregate amount of the taxpayer's double-taxed income, divided by the taxpayer's Illinois base income.
- 1) In computing the aggregate amount of the taxpayer's double-taxed income, any item of income or deduction taken into account in more than one state shall be taken into account only once. For example, an individual subject to tax on his or her compensation by both State X and by a city in State X shall include the amount of such compensation only once in computing the aggregate amount of double-taxed income.
 - 2) Because base income subject to tax both in another state and in Illinois cannot exceed 100% of base income, the credit cannot exceed 100% of the tax otherwise due under IITA Section 201(a) and (b).
 - 3) No carryover of any amount in excess of this limitation is allowed by the IITA.
- e) Disallowance of credit for taxes deducted in computing base income. *The credit provided by IITA Section 601(b)(3) shall not be allowed if any creditable tax was deducted in determining base income for the taxable year.* (IITA Section 601(b)(3)) A trust that has deducted the amount of a state tax imposed upon or measured by net income may include such tax in the computation of the credit allowed under this Section, but IITA Section 203(c)(2)(F) requires that trust to add back to its federal taxable income *an amount equal to the tax deducted pursuant to section 164 of the Internal Revenue Code if the trust or estate is claiming the same tax for purposes of the Illinois foreign tax credit.* The amount that must be added back for a taxable year shall be the amount of tax deducted for such year on the trust's federal income tax return. Because no similar provision is made for individuals, an individual who has deducted taxes paid to another state in computing his or her federal adjusted gross income may not claim a credit for such taxes on his or her Illinois tax return.
- f) Credit for taxes paid on behalf of the taxpayer. An Illinois resident individual who is a shareholder or partner claiming a foreign tax credit for the shareholder's or partner's share of personal income taxes paid to a foreign state on his or her behalf by a

Subchapter S corporation or a partnership, respectively, must attach to his or her Illinois return a written statement from the Subchapter S corporation or partnership containing the name and federal employee identification number of the Subchapter S corporation or partnership and clearly showing the paid amount of foreign tax attributable to the shareholder or partner, respectively. Additionally, the statement must include the shareholder's or partner's share of the Subchapter S corporation's or partnership's items of income, deduction and exclusion in sufficient detail to allow computation of the amount of base income subject to tax under subsection (b)(4) of this Section. Taxes imposed directly on the Subchapter S corporation or the partnership are not eligible for the credit.

- g) Documentation required to support claims for credit. Any person claiming the credit under IITA Section 601(b)(3) *shall attach a statement in support thereof and shall notify the Director of any refund or reductions in the amount of tax claimed as a credit under IITA Section 601(b)(3) all in such manner and at such time as the Department shall by regulations prescribe.* No credit shall be allowed under this Section for any tax paid to another state nor shall any item of income be included in base income subject to tax in that state except to the extent the amount of such tax and income is evidenced by the following documentation attached to the taxpayer's return (or, in the case of an electronically-filed return, to the taxpayer's Form IL-8453, Illinois Individual Income Tax Electronic Filing Declaration), amended return or claim for refund:
- 1) Unless otherwise provided in this subsection (g), a taxpayer claiming the credit must attach a copy of the tax return filed for taxes paid to the other state or states to the taxpayer's Illinois income tax return, Form IL-8453, amended return or claim for refund.
 - 2) If the tax owed to the other state is satisfied by withholding of the tax from payments due to the taxpayer without the necessity of a return filing by the taxpayer, the taxpayer must attach a copy of the statement provided by the payor evidencing the amount of tax withheld and the amount of income subject to withholding.
 - 3) A taxpayer claiming a credit for taxes paid by a Subchapter S corporation or partnership on the taxpayer's behalf must attach a copy of the statement provided to the taxpayer by the Subchapter S corporation or partnership pursuant to subsection (f) of this Section, showing the taxpayer's share of the taxes paid and the income of the taxpayer on which the taxes were paid.

(Source: Amended at 32 Ill. Reg. 1407, effective January 17, 2008)